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SUBJECT: SALVADORAN ECONOMIC INDICATORS SHOW CONTRACTION, LIKELY RECESSION

REF: SAN SALAVDOR 230

Summary

¶1. The Government of El Salvador (GOES) cut its official projection for 2009 GDP growth to less than 1 percent. The GOES's GDP proxy has fallen for the last five months, and the Central Bank President expects 2008 GDP growth figures of about 2.5 percent, far below the original projection of 4.5-5.5 percent. Remittances have likewise fallen for five straight months, tax collections are down, and exports have dropped for the second consecutive month. Standard & Poor's and Fitch have maintained their BB+ ratings with negative outlooks. Salvadoran economists are split on whether the country is already in recession. If historical trends of a 4-6 month lag between the U.S. and Salvadoran economies hold, however, the economic situation will likely continue to deteriorate. End summary.

Economic Activity Down and Lower GDP Growth Projection
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¶2. On March 23, the GOES cut its official economic growth projection for 2009 from 2 percent to less than 1 percent. During 2008 the GOES reduced the 2009 projection twice from the budget assumption of 4.5-5.0 percent, first to 2.5 percent and then to 2 percent. The Index of the Volume of Economic Activity (IVAE), a Central Bank GDP proxy, was negative for the last four months of ¶2008. In September 2008 the index was down 0.06 percent, in October down 0.7 percent, in November down 1.27 percent and for December down 1.69 percent. For January 2009, the IVAE fell 2.9 percent. The initial decline was led by the construction and mining sectors. By January, however, most sectors had turned negative, including retail, restaurants and hotels, real estate, services to businesses, utilities and manufacturing. Only agriculture, government services, and banking were still showing growth. While the Central Bank has not yet released full-year GDP data, Central Bank President Luz Maria de Portillo announced on March 26 that 2008 GDP growth was likely to be around 2.5 percent, far below the 4.5 to 5.5 percent the GOES originally projected.

Remittances Also Falling

¶3. Remittances fell for five consecutive months between October 2008 and February 2009, the latest data available. In the last three months of 2008, remittances fell 6 percent, 6.6 percent and 3.9 percent respectively. In January they decreased by 8.4 percent and in February by 7.8 percent. For the first two months of 2009, accumulated remittances totaled $527.5 million, 8.1 percent below the same period of 2008. According to leading Salvadoran think tank FUSADES, remittance rates have a strong inverse correlation with Hispanic unemployment rates in the U.S.

Lower Tax Revenue

¶4. Tax collection fell by 12 percent in January 2009 to $234.3 million. The Value Added Tax (VAT) fell by 25 percent to $98.6 million and import taxes fell by 32 percent to $10 million. Non-tax government fees (e.g., licenses, registrations, traffic tickets) also fell by 49.5 percent. Minister of Economy, Ricardo Esmahan stated that lower oil prices alone will reduce tax collection by $156 million in 2009.

Foreign Direct Investment Showing some Reduction

¶5. Official statistics for Foreign Direct Investment (FDI) have not been published, but the Salvadoran Investment Promotion Agency's (PROESA) annual report for 2008, released in mid-December 2008, reported a 62 percent reduction compared to 2007. PROESA attributed much of that difference to the international purchases of Salvadoran banks in 2007. Also, according to PROESA analyst David Portillo, many foreign direct investments that were being planned have come to a halt due to a lack of financing, especially in the tourism sector. Vice President Ana Vilma de Escobar, who serves as head of PROESA, told the press that FDI in January 2009 was down 30 percent compared to January 2008.

Exports drop again

¶6. Exports fell for the second straight month (reftel), with accumulated exports for January-February down 11.7 percent compared to 2008. Traditional exports fell by 20.6 percent mainly due to lower sugar exports. Non-traditional exports only fell by 2.5 percent. Maquila exports fell 19.9 percent and maquila-related imports fell 39.7 percent. Total imports through February were down

25.7 percent compared to the same period in 2008.

Credit Ratings

¶7. Standard & Poor's and Fitch both maintained El Salvador's BB+ rating, with a negative outlook, in statements published shortly after the March 15 Presidential election. Both rating agencies stated that the U.S. recession and an external liquidity shortage will have a strong negative effect on El Salvador. S&P cited the speed of the transition to the new government and political polarization as short-term political risk factors. Provided the Funes government follows moderate policies, however, S&P cited the peaceful alternation of parties in power as a long-term positive for the credit rating.

Comment

¶8. Salvadoran economists are split on whether El Salvador is already in recession. Based on past recessions, most Salvadoran economists have predicted 4-6 month lag between what happens in the U.S. economy and what happens in El Salvador. If that relationship holds in the current recession, we are only now starting to see the effects of economic events between August and October in the U.S., and the Salvadoran economy is likely to deteriorate further.

Blau